

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

NEW ENGLAND POWER COMPANY)
THE NARRAGANSETT ELECTRIC COMPANY)
USGEN NEW ENGLAND, INC.)
APPLICATION FOR REQUIRED APPROVALS)
UNDER SECTION 203 AND 205 OF THE)
FEDERAL POWER ACT FOR DIVESTITURE OF)
GENERATING BUSINESS AND RELATED MATTERS)

DOCKET NO. _____

DIRECT TESTIMONY

OF

THOMAS W. WIDENER

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INTRODUCTION

Q. Please state your name, employer, and business address.

A. My name is Thomas W. Widener. I am employed by Merrill Lynch & Co. in the Investment Banking Division. My business address is World Financial Center - North Tower, New York, New York.

Q. Please summarize your professional and education background.

A. I am a Director in the Investment Banking Group at Merrill Lynch. I have been at Merrill Lynch for more than 12 years, during which time I have worked primarily with power companies on financing and strategic assignments. I have substantial experience in strategic assignments involving generating assets and in project financings involving power assets. Since 1992, I have been responsible for Merrill Lynch's worldwide activities involving generating companies and generation assets and have, during that time, led teams on assignments involving the acquisition or sale of generating assets in the U.S., Argentina, Australia, Chile, China, Mexico, and Peru. We have been engaged by both potential buyers and sellers on these assignments. Recently, I led the Merrill Lynch team that advised Commonwealth Edison on its sale of its Kincaid and State Line generating stations (aggregating 1600 MW). I have a Bachelor of Arts Degree in Economics from the University of Virginia.

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PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe the sale process used by New England Power Company (NEP) to sell substantially all of its non-nuclear generating assets, including the manner in which NEP solicited and provided information to bidders and the structure of the bidding process.

OUTLINE OF TESTIMONY

Q. Please describe how your testimony is organized.

A. My testimony that follows has six parts. First, I outline Merrill Lynch's role in the divestiture. Second, I describe the planning portion of the divestiture process. Third, I describe the bidder solicitation process. Fourth, I provide an overview of the bidder qualification and initial proposal process. Fifth, I describe how second round bidders were selected. Finally, I describe the second, binding round of the sale process leading to the selection of the winning bidder.

MERRILL LYNCH ROLE IN DIVESTITURE PROCESS

Q. What role did Merrill Lynch play in the NEP divestiture?

A. Merrill Lynch has acted as a financial adviser to the New England Electric System Companies (NEES) over the past two years on a variety of strategic matters. We were appointed as exclusive financial advisor in connection with the divestiture at the time that NEP made its decision to divest its non-nuclear generation in late September of 1996. Merrill Lynch advised NEP on all aspects of the divestiture process and was involved in structuring the sale

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process, solicitation of bidders, evaluation of proposals, and negotiations with the buyer.

Q. What experience did Merrill Lynch have regarding the sale of assets prior to being engaged by NEP for this sale?

A. Merrill Lynch has been involved on behalf of either buyers or sellers in a number of sale transactions involving more than 50 operating generating stations worldwide. In addition, we have been involved in a significant number of merger-related transactions involving power companies where generating assets were a significant component of value as well as more than 200 divestitures generally, with disclosed values of more than \$ 40 billion, since 1991. I have attached as Exhibit TWW-1 a list of strategic assignments in the power industry recently completed by Merrill Lynch, with a brief description of each.

Q. What role did you play with respect to the divestiture of NEP's generating business?

A. I led the Merrill Lynch team involved in this assignment. The Merrill Lynch team included a number of experienced professionals from both our Global Power and Mergers & Acquisitions groups.

PLANNING THE SALE PROCESS

Q. Please describe the initial steps that were taken to commence the sale process.

A. NEP asked Merrill Lynch to work closely with a team of New England Power Service Company (NEPSCO) personnel to develop a sale process and

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transaction schedule that would achieve the primary objective identified by NEP, which was to maximize the value NEP received from the sale. In addition, NEP also sought to maximize the opportunities for employees of NEP.

Q. Please explain the two objectives.

A. By maximizing the value NEP receives from the sale, NEP was attempting to minimize contract termination charges to be paid by the customers of NEP's retail affiliates. At the same time, NEP was committed to maximizing opportunities for NEP employees in the generation business, including both union and non union personnel. Under its collective bargaining agreements, NEP also was obliged to use its best efforts to cause purchasers to assume NEP's obligations under those agreements.

Q. Please explain the initial strategy that was developed for the sale.

A. The primary goals of the sale process itself included the solicitation of all likely bidders for all or a portion of the business and the encouragement of those bidders likely to ascribe maximum value to the assets being sold. Working together, NEP and Merrill Lynch identified a number of key components in connection with the sale process, including: (1) NEP should proceed as expeditiously as possible with the sale; (2) NEP should offer its nuclear entitlements in a separate sale process; (3) NEP should provide prospective purchasers with flexibility as to which portion(s) of the NEP generation business could be bid for; and (4) NEP should conduct a multi-stage bidding process.

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Q. Please explain why the sale process was commenced expeditiously.

A. We believed that there was significant value in moving quickly as it allowed NEP to take advantage of a "seller's market" for generating assets with many more potential buyers than sellers. Moving quickly also positioned NEP as the only seller in the U.S. market at the time thereby maximizing potential buyers' interest and focus. We shared the belief with NEP that the imbalance of supply and demand for generating assets, combined with the unique quality of NEP's generating business within New England, would lead to aggressive bidding. We advised NEP that if it delayed proceeding with the sale it was likely that other utilities (both within the region and elsewhere in the U.S.) would offer generating assets for sale, increasing the choices for prospective purchasers and thereby potentially reducing value. As a result, the process was commenced in the fourth quarter of 1996.

Q. Please explain why sale of the nuclear entitlements was deferred.

A. We felt that the inclusion of the nuclear entitlements in the fossil and hydro package would substantially impair interest in the non nuclear assets and thereby likely reduce value. Once NEP had made the decision to separate the nuclear entitlements, we believed that it made sense to defer the separate offering of the nuclear interests until the market was further established, and buyers for nuclear assets had begun to emerge.

Q. Please explain how the business units were developed.

A. Both Merrill Lynch and NEP believed that it was important to allow prospective purchasers to define the packages of assets that created the most value. As such, we offered prospective purchasers the option to

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purchase the entire non-nuclear business or any one or combination of six separate business units. For purposes of the sale, those business units were: Salem Harbor, Brayton Point, Manchester Street, Conventional Hydro, Pumped Storage, and Power Contracts. Attached as Exhibit TWW-2 is a table showing the business units. Each business unit contained both physical assets as well as an allocation of NEP's related assets and obligations. By offering up separate business units, NEP could take advantage of the possibility that different purchasers would place different values on NEP's diverse assets. It also expanded the universe of prospective purchasers with the financial capability to participate in the sale and minimized the chance that the entire package would be too large for even the most aggressive bidders. At the same time, NEP allowed potential purchasers to package business units in ways that they believed created value which maximized the potential that buyers would pay additional amounts for synergies that existed among NEP's various generating stations.

Q. Please explain the sale process stages.

A. We first identified, targeted, and qualified potential purchasers. Following the identification and qualification of potential purchasers, we essentially used a two stage sale process. In the first round, NEP sought non-binding proposals that would be used to determine who among prospective purchasers were likely to place the highest value on the generating business. The first round also was used to conduct market testing of potential sale parameters such as how to deal with the above market power contracts and the willingness of prospective purchasers to assume collective bargaining agreements. The second stage involved the submission of binding proposals from a relatively

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small group of finalists made up of those companies deemed most likely to provide maximum value for the business in the second, binding round. Once binding bids were received, we conducted further negotiations with the top bidders.

- Q. Were other alternatives to the multi-stage bidding process considered?
- A. Yes. NEP considered whether greater value could be obtained through an open, single stage plant-by-plant auction, but we and NEP believed that such an auction would likely achieve less value for the generating business.
- Q. Why did Merrill Lynch advise NEP that a plant-by-plant auction would likely achieve less value?
- A. There were a number of reasons. First, it was our opinion that given the clearly substantial level of interest in NEP's assets, the cost to bidders to participate should be relatively low, given that the odds of prevailing in the auction would also be low. Given the nature of purchasing a generating business or large generating asset, the price of putting in an aggressive, binding bid for any of NEP's assets is not low; a serious bidder might have to spend over \$1 million in direct costs retaining market, engineering and environmental consultants to evaluate the economics of a single major generating business, and, in addition, devote substantial time and effort. With the large number of interested purchasers well known, we believed it was unlikely that many of those companies would expend the maximum effort necessary to put in their best bid until they had a better idea as to their chance of success. The multi-stage process allowed bidders to participate at a relatively low cost within a reasonable time period. Bidders who were invited

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to participate in later stages then had greater incentive to spend the resources required to make a binding proposal. Another reason that it was not, in our view, optimal to apply the open auction, plant by plant approach to the sale of NEP's business was we believed that substantial value could be lost through a plant by plant sale, given the potential synergies and value of packages, if potential buyers were unable to bid the packages. Furthermore, we believed it useful to provide purchasers some flexibility and allow them to propose exceptions to terms, potentially leading to negotiations over terms and conditions of the sale and producing incremental value for NEP. Finally, an additional potential advantage to the process used here is that it allows a seller to capture incremental value in situations where the highest bidder is willing to pay significantly more than the next highest bidder.

Q. What about a spin off?

A. Merrill Lynch and NEP carefully evaluated the likely value NEP would receive for its generation business through a sale versus a spinoff. Based on market conditions, we concluded that a sale would almost assuredly achieve a higher value than a spinoff, and allow NEP to definitively establish the market value of its generating business. In sum, we believed that a spinoff was likely to undervalue the business, while a sale would likely result in achieving a premium value for the generating business. NEP reserved the right in the sale process to reject all bids and proceed with a spin off if we and NEP concluded that a spin off would produce more value.

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SOLICITING BIDDERS

Q. How did Merrill Lynch solicit interested purchasers?

A. We began the process in late November and early December, 1996, by mailing a "sale summary" and a letter to a large group of potential bidders that Merrill Lynch and NEP had identified. The materials described NEP's generating business in general terms and set forth initial transaction parameters. A copy of the sale summary and letter is included as Exhibit TWW-3. A list of bidders receiving the letter, the sale summary, or both is provided as Exhibit TWW-4. In addition, NEP's commitment to divest became widely known publicly after NEP's settlement in Massachusetts was announced. As public knowledge of NEP's proposed divestiture of its generation business increased through the trade press, Merrill Lynch and NEP received inquiries from other prospective bidders, and we added them to the list of potential buyers.

Q. How were initial discussions with potential bidders coordinated?

A. In order to assure a fair and unbiased sale process, we informed prospective bidders that all contacts regarding the sale should be made through Merrill Lynch and that NEES and NEP should not be contacted directly. NEES personnel also were informed that all contacts from prospective bidders were to be referred to Merrill Lynch.

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EARLY STAGES OF PROCESS

Q. Please describe the bidder qualification process.

A. The letter and sale summary sent by Merrill Lynch describing the assets and the process requested, to the extent that an interested party wanted to pursue this opportunity, qualification information and execution of a confidentiality agreement. Information required to qualify to bid included:

- (1) a brief description of the bidding company or consortium;
- (2) a summary of operating experience in the energy industry for the prospective bidding group, focusing on experience involving power stations with at least 250 MW of generating capability or the equivalent in the case of energy or power marketing experience; and
- (3) demonstrated or prospective ability to close an acquisition transaction of the magnitude contemplated, focusing on values of at least \$250 million.

Qualification processes are in our view desirable as a means of assuring that seller resources and attention can be focused on real potential buyers who are most likely to submit fully-financed bids rather than those simply interested in obtaining information. Qualified bidders who executed a confidentiality agreement also were provided a confidential Preliminary Information Memorandum, containing a more detailed description of the generation business and technical information about the assets. In addition, bidders were provided:

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- (1) a Hydro Reference Manual and Thermal Stations Reference Manual, containing additional information about the organization and assets;
- (2) procedures and guidelines for the Data Room; and
- (3) a master list detailing information then available in the Data Room.

Q. How did prospective bidders obtain more detailed information about the assets?

A. NEP opened a Data Room in Boston to provide prospective bidders the opportunity to review documents containing detailed technical data and operating history and information on the generating stations. As part of the Data Room process, prospective bidders also were allowed to submit questions to Merrill Lynch, and answers to those questions deemed material to the preparation of an initial proposal were provided to all prospective bidders.

Qualified bidders subsequently were provided with a confidential Information Memorandum containing detailed descriptions of all Business Units, NEP's non-nuclear generation business as a whole (referred to as NEPGen), the developing market for electricity in New England, financial information, selling parameters, and proposal requirements.

In addition, prospective bidders were given the opportunity to participate in half-day "walking tours" of the three fossil-fueled generating stations, the Bear Swamp pumped storage facility, and selected hydroelectric stations along the

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Connecticut and Deerfield rivers, and an opportunity to ask questions of senior plant personnel.

- Q. How many prospective purchasers signed confidentiality agreements and qualified to bid?
- A. Approximately 80. Approximately 50 of those subsequently visited the Data Room and/or visited some or all of the plants.

FIRST ROUND PRELIMINARY PROPOSALS

- Q. What were the parameters given to bidders for the first round proposals?
- A. Bidders were provided the general terms and conditions of the sale, including the required assumption by potential purchasers of (1) NEP's interest in long-term sales contracts, (2) onsite environmental liabilities and (3) NEP's obligations under the Massachusetts Settlement and the Rhode Island Utility Restructuring Act of 1996. The terms and conditions were generally designed to assign to the buyer all of NEP's assets and obligations related to its generating business, not just the physical assets represented by its generating facilities. Included in the obligations to be assumed by the buyer was the assumption of the obligation to provide standard offer service, consistent with the terms of the Massachusetts Settlement Agreement.
- Q. What information were bidders required to supply in their initial proposals?
- A. The information bidders were asked to supply included:
- (1) Description of the bidding entity or group, including all equity participants;

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- (2) Clear identification of the business units for which the preliminary proposal were being submitted;
- (3) A non-binding proposed purchase price;
- (4) A description of the financing plan contemplated for the potential acquisition;
- (5) A list of additional information and/or due diligence required to submit a binding bid;
- (6) Operating plan for the Business Unit(s), including (in general terms) proposed staffing levels and expectations for current plant employees together with an indication as to the level of administrative staff and services likely to be requested from NEP or NEPSCO administrative support;
- (7) A statement of intent with respect to the existing collective bargaining agreements;
- (8) A list of corporate, shareholders or regulatory approvals required and an estimated time frame for such approvals;
- (9) Any exceptions to the transaction parameters outlined in the Information Memorandum; and
- (10) Confirmation that the proposal was not subject to any financing contingencies.
- (11) To the extent the proposal included a bid for the Power Contracts, the amounts to be paid by NEP and the term over which those payments were to be made.

In preparing their proposals, bidders were asked to make certain simplifying assumptions, primarily in connection with environmental matters and hydroelectric relicensing. We sent bidders a letter with final bidding

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instructions from Merrill Lynch in early March 1997, a copy of which is included as Exhibit TWW-5

Q. Were bidders given any other advice in submitting their proposals?

A. Yes. In order for NEP to meet its obligations under its collective bargaining agreements whereby NEP agreed to use its best efforts to have a buyer assume those agreements (and consistent with its goal of maximizing opportunities for employees) bidders were advised that, assuming no material difference in value, NEP would look more favorably upon bidders who agreed to assume the collective bargaining agreements. In addition, bidders were advised that assuming there was no material difference in value, NEP would look more favorably upon proposals for the entire enterprise (e.g. NEPGen).

Q. How many prospective purchasers submitted preliminary proposals and how many preliminary proposals were received?

A. On March 21, 1997, 25 prospective purchasers submitted 41 proposals for all or part of the generating business.

Q. What kinds of preliminary proposals were made?

A. The majority of the bidding groups submitted proposals for the entire generating business; some of these groups also submitted proposals for individual business units or combinations of business units. The other bidding groups submitted proposals ranging from a single business unit to all of the business units excluding the Power Contracts.

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SELECTING THE FINAL GROUP

- Q. How did the Company make its determination of who would be invited to submit binding proposals in the final round?
- A. Bidders were "short listed" based on an assessment of which were most likely to provide maximum value in the second, binding round; that is, to produce the largest reduction of customer stranded cost charges. We took into consideration the indicative price bid, other proposal terms and the ability and track record of the bidder to deliver on its bid and to close the sale, as shown by past experience of the bidder. Using this criteria, NEP invited a select group of bidders to make binding proposals. We strove to short list all of the bidders reasonably likely to submit the most value in the second round, while keeping the list short enough to incentivise the participation of those most likely to deliver maximum value.
- Q. Did the preliminary proposals provide any guidance as to how the second round of bidding should be structured?
- A. Yes. In the first round, no bidder separated the conventional hydroelectric business unit from the pumped storage business unit, all of the best proposals kept all of the fossil fuel business units together, and bidders generally ascribed significant value to packages of assets. As a result, the first round proposals indicated the highest value could be obtained through the sale of the enterprise as a whole or in two business units. Therefore, for the second round, the six business units were consolidated into two business units. One of the business units was made up of the fossil fuel business units combined with the power contract business unit. The other business unit was made up of the conventional hydroelectric business unit combined with the pumped

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storage business unit. First round bidders also were interested in acquiring the purchased capacity as part of a larger package, and did not indicate that the assumption of the "main table" collective bargaining agreements materially diminished value.

Q. How many bidders were selected for the second round?

A. Seven bidders were invited to make second round proposals. Five of the bidders were invited to make bids on either or both business units, while two of the bidders were invited to make bids on the hydro business unit.

CONDUCTING THE SECOND ROUND

Q. Please describe the key decisions that were made for structuring and conducting the second round.

A. First we structured the process to include two business units, fossil and hydro, as I explained earlier. Second, we eliminated the simplifying assumptions which first round bidders were asked to make in their initial proposals, as provided in the final bidding instructions sent to bidders in March (See Exhibit TWW-5). In the second round, bidders were provided access to detailed information to allow them to formulate their own assumptions with regard to environmental and relicensing issues and to price those assumptions into their proposals. Third, we required assumption of the "main table" collective bargaining agreement, based on our conclusion that such a condition would not materially diminish value. Finally, the PPAs were included as a required part of the fossil business unit or of NEPGen, together with a fixed schedule of payments from NEP, since we were confident that the assumption of these

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contracts would not diminish overall value (once the NEP payments were considered.)

Q. What happened after the final group was selected?

A. Bidders were given the opportunity to commence their final due diligence efforts in late April. Due diligence included access to NEP's facilities and meetings with NEP and NEPSCO personnel.

Q. How were the second round bids evaluated?

A. Bidders were asked to supply a fixed price bid for the business unit or units they were interested in purchasing. Bidders also were required to note any exceptions to the transaction documents provided to them. The bids were evaluated on the basis of which bid or combination of bids (for separate business units) produced the highest purchase price, and thereby the lowest contract termination charges, taking into consideration any exceptions regarding the terms of the sale. The U.S. Generating winning bid met that criteria after negotiations were completed.

Q. In your opinion, was the bidding process fair and open?

A. Yes. Reasonable procedures were put in place to provide all qualified bidders with equal access to relevant information and a fair opportunity to compete.

Q. In your opinion, did the selection of U.S. Generating result in NEP achieving its objective of maximizing the value it received from the sale?

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A. Yes. U.S. Generating submitted the highest, best bid in a process that had attracted likely purchasers and successfully encouraged their participation.

Q. Does that conclude your testimony?

A. Yes.